

Rev. Rul. 76-348

In 1961, *A*, with individually owned funds, purchased a parcel of real property located in State *X*, and had it titled in the names of *A* and *B* (*A*'s spouse) as tenants by the entirety. Pursuant to section 2515(a) of the Internal Revenue Code of 1954, *A* did not elect to report a gift to *B* at the time they took title to the property as tenants by the entirety.

Under the law of State *X*, where *A* and *B* resided and where the real property was located, a tenancy by the entirety cannot be severed by either spouse acting alone, and each spouse is entitled to one-half the income from such property. In 1975, *A* and *B*, pursuant to an estate planning arrangement, gratuitously transferred the real property to their children. For Federal gift tax purposes, the transfer was reported as wholly a gift by *A*. Nine months after the transfer, *B* died of incurable cancer.

Following *United States v. Heasty*, 370 F. 2d 525 (10th Cir. 1966), which decided that the interest of joint tenants in real property must be determined according to local property law and not by a Federal estate tax concept of transfer, Rev. Rul. 69-577, 1969-2 C.B. 173, holds that if under applicable local law each spouse is entitled to one-half the income from property held in tenancy by the entirety, the cotenants' interest in the property is essentially the same as that in a joint tenancy. Under such circumstances, that Revenue Ruling holds that one-half the value of trust property is includible in each cotenant's gross estate under section 2036(a) (1) of the Code (dealing with transfers with retained life estate) if tenancy by the entirety property is transferred in trust to pay one-half the income therefrom to each spouse during their joint lives and the entire income to the survivor for life, and the remainder to a third person. In *Sullivan's Estate v. Commissioner*, 175 F. 2d 657 (9th Cir. 1949), the court, in

reversing the Tax Court, held that only one-half the value of property held in joint tenancies, which had been terminated in contemplation of death within the meaning of section 811 of the Internal Revenue Code of 1939 (predecessor of section 2035 of the 1954 Code), was includible in the decedent's gross estate even though the decedent furnished the entire consideration for the properties. *Accord*, *Edward Carnall*, 25 T.C. 654 (1955), *acq.* 1969-2 C.B. xxiv; *A. Carl Borner*, 25 T.C. 584 (1955), *acq.* 1969-2 C.B. xxiii; and *Don M. Brockway*, 18 T.C. 488 (1952), *acq.* 1969-2 C.B. xxiv.

Held, since, under the law of State *X*, *A* and *B* are each deemed to have acquired a half interest in the property at the time the tenancy by the entirety was created, one-half the value of the property transferred within three years of *B*'s death, in furtherance of an estate planning arrangement, is includible in *B*'s gross estate under section 2035 of the Code, notwithstanding the Federal gift tax election made by *A* to not report a gift to *B* at the time they initially took title to the property as tenants by the entirety.

Section 2036.—Transfers with Retained Life Estate

26 CFR 20.2036-1: *Transfers with retained life estate.*

Charitable remainder unitrust; valuation. The entire value of the corpus of an inter vivos charitable remainder unitrust from which the grantor retained a life payment of a unitrust adjusted payout rate of 5.660 percent or greater is includible in the decedent's gross estate. The method is provided to compute the proportion of the trust assets includible in the gross estate for a unitrust adjusted payout rate less than 5.660 percent.

Rev. Rul. 76-273

Advice has been requested whether

the value of the corpus of an inter vivos charitable remainder unitrust is includible under section 2036 of the Internal Revenue Code of 1954 in the circumstances described below; and if so, the proper method of determining the includible portion.

In November 1969, *A* created a charitable remainder trust, naming *M* trust company as trustee. The provisions of the trust instrument met all the requirements of a charitable remainder unitrust as described in section 664 of the Code. The trust instrument directed the trustee to hold, invest, and reinvest the corpus of the trust and pay quarterly to *A*, for life, an amount equal to 6 percent of the fair market value of the trust as valued on the first day of each taxable year of the trust. Based on section 1.664-4(b) (2) of the Income Tax Regulations, the appropriate adjusted payout rate for the unitrust was 5.871 percent. At the termination of the trust, the then corpus, together with any and all the accrued income, was to be distributed to a charitable organization. *A* died in May 1975.

Section 2036 of the Code provides:

The value of the gross estate shall include the value of all property to the extent of any interest therein of which the decedent has at any time made a transfer (except in the case of a bona fide sale for adequate and full consideration in money or money's worth), by trust or otherwise, under which he has retained for his life or for any period not ascertainable without reference to his death or for any period which does not in fact end before his death—

(1) the possession or enjoyment of, or the right to the income from, the property,
* * *

Section 20.2036-1(a) of the Estate Tax Regulations provides:

If the decedent retained or reserved an interest or right with respect to all of the property transferred by him, the amount to be included in his gross estate under section 2036 is the value of the entire property, less only the value of any outstanding income interest which is not subject to the decedent's interest or right and which is actually being enjoyed by another person at the time of the decedent's death.

Under the Code and regulations,

the includibility in the gross estate of the assets of a trust in which the deceased grantor has retained a lifetime income interest is predicated upon three requirements: (1) there must be an inter vivos transfer by the decedent in trust or otherwise; (2) decedent must have retained the possession or enjoyment of, or the right to income from, the property; (3) such retention or reservation must have been for decedent's life or for any period not ascertainable without reference to his death or for any period which does not in fact end before his death. *Richards v. Commissioner*, 375 F. 2d 997 (10th Cir 1967); *Kasishke v. United States*, 426 F. 2d 429 (10th Cir. 1970).

The language of section 2036 of the Code is very broad and its application extends to all property to the

$$\text{Equivalent income interest rate} = \frac{\text{Unitrust adjusted payout rate}}{1 \text{ minus adjusted payout rate}}$$

In the present case, the interest retained by *A* had an adjusted payout rate of 5.871 percent. It thus exceeded the payout rate (5.660%) that is equivalent to a full income interest in the trust assets. Therefore, *A* effectively retained the income from all the assets transferred to the unitrust. Cf. *Smith v. Westover*, 89 F. Supp. 432 (S.D. Cal. 1950), *aff'd per curiam*, 191 F. 2d 1003 (9th Cir. 1951).

A has retained an amount which is a charge against the whole corpus and which is payable in all events, regardless of available income. The tax consequences of a transaction depend on the substance of the transaction rather than its form. *Helvering v. Clifford*, 309 U.S. 331 (1940); *Spiegel's Estate v. Commissioner*, 335 U.S. 701 (1949).

Accordingly, since *A* retained for life an interest at least equal to the right to the income from all the property transferred by *A* to the charitable remainder unitrust, the entire value of the property in such trust is includible in *A*'s gross estate under section 2036(a)(1) of the Code. If *A* had

extent of any interest therein transferred by the decedent.

Under section 2031 of the Code and section 20.2031-10 of the regulations, an interest rate of six percent per annum is used for valuation purposes with respect to decedents dying after December 31, 1970. See also section 1.664-4(a)(1)(ii) of the Income Tax Regulations. Here, strictly speaking, *A* did not retain the right to the income from the property transferred, but retained instead the right to receive the unitrust amount.

The life beneficiary of a unitrust having an adjusted payout rate of 5.660 percent receives, in effect, the entire income from the trust assets where those assets are assumed to produce a six percent return on investment. The rate of 5.660 percent results from the following formula:

$$\text{Unitrust adjusted payout rate} \\ 1 \text{ minus adjusted payout rate}$$

retained the right to a unitrust amount having an adjusted payout rate of less than 5.660 percent, then a correspondingly reduced proportion of the trust assets would be includible in the gross estate under section 2036(a)(1). The includible portion would be determined by using the above formula to obtain the equivalent income interest rate for the trust, and then dividing that equivalent rate by six percent. Thus, the decedent's interest or share in the income rights would have to reflect the proportionate value of the property interest to which the income rights relate. *Uhl v. Commissioner*, 241 F. 2d 867 (7th Cir. 1957); *U.S. National Bank of Portland v. United States*, 188 F. Supp. 332 (D. Ore. 1960); and *Estate of Marvin L. Pardee*, 49 T.C. 140, 149-50 (1967).

Section 2038.—Revocable Transfers

26 CFR 20.2038-1: Revocable transfers.

Gross estate; death benefit under

employment contract. The death benefit provision of an employment contract providing if death occurred during the term of the contract the employer would pay the benefit to the decedent's designated beneficiary, which the decedent could change during the course of employment, satisfies the transfer requirement of section 2038(a)(1) of the Code and the amount of the death benefit will be includible in the decedent's gross estate.

Rev. Rul. 76-304

Advice has been requested whether a payment made to a decedent's surviving spouse by the decedent's employer is includible in the decedent's gross estate under section 2038(a)(1) of the Internal Revenue Code of 1954, under the circumstances described below.

On January 1, 1975, the decedent and *X* Corporation entered into an employment contract whereby, in consideration of the decedent's performance of services, the corporation agreed to pay decedent a stated yearly salary and also agreed to pay a death benefit of a stated amount to decedent's designated beneficiary if decedent was employed by the corporation at date of death. Under the terms of the agreement decedent could change the beneficiary of the payment during the course of employment with the corporation.

Upon decedent's death on September 12, 1975, while employed by the corporation the death benefit was paid to the decedent's surviving spouse.

The issue presented is whether the transfer requirement of section 2038(a)(1) of the Code is satisfied where a decedent-employee procured the transfer by such decedent's employer of a death benefit to the decedent's surviving spouse in return for the performance of services during the course of employment.

Section 2038(a)(1) of the Code provides that the value of the gross